

HELLENIC DEPOSIT GUARANTEE FUND

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The Hellenic Deposit Guarantee Fund (TEK) is the body responsible for the implementation and management of the Greek deposit guarantee scheme, whose aim is to guarantee bank deposits. Set up in 1995, the Fund not only ensures an important measure of stability in the Greek banking system but also plays a significant social role. During the four years since its foundation, TEK has developed rapidly, increasing its assets and maximising the returns thereon. Yet, the general public

remains largely unaware of TEK's role in protecting depositors against the risk of deposits being unavailable. This publication therefore seeks to provide savers and specialists with comprehensive information on the subject of the Greek deposit guarantee scheme. It is my belief that, by making the role and standing of the guarantee scheme more widely known to the public, we shall further enhance broad confidence in the country's banking system.

Nicholas C. Garganas
Chairman of the Board
Deputy Governor of the Bank of Greece

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HELLENIC DEPOSIT GUARANTEE FUND (TEK)

Introduction

The failure of just one credit institution to meet its obligations toward its depositors may be sufficient to disturb the smooth functioning and stability of a country's credit system as a whole. The pivotal role of the banking industry in the economic activity of a country highlights the need for a system that can indemnify the depositors of a failed bank. When the credit system operates normally, savers have a sense of security and predictability that minimises the risk of a depositor confidence crisis, whether partial or general.

Thus, there is a significant social dimension to deposit protection, insofar as it counteracts the relatively limited access to information and handling ability of investors, in particular of those with small and medium-sized credit balances. It is no coincidence that the concept of deposit protection emerged in the United States at the time of the Great Depression of 1929.

Today, the role and significance of deposit guarantee schemes are constantly growing as a result of the increasing interplay between economies and heightened risks of financial shocks spilling over rapidly within or beyond regional and national borders. The vast majority of developed countries and banking systems run deposit guarantee schemes of one description or another. The issue of EU-wide harmonisation across the various national deposit guarantee authorities thus needs

to be addressed, as does also closer cooperation between such bodies on a broader international level.

The Greek deposit guarantee scheme was introduced by act of parliament (Law 2324/95), coming into effect in July 1995. The law was based on EC Directive 94/19/EC on deposit guarantee schemes (see Annex II) and established the Hellenic Deposit Guarantee Fund (TEK) as manager of the scheme, which started operating at the end of the same year as a legal entity governed by private law. Its stated objective is to pay compensation to holders of deposit accounts with credit institutions whose head offices are located in Greece or with branches of non-EU based credit institutions operating in Greece and participating in TEK, in the event that such institutions fail to return their deposits. TEK also covers deposits held with Greek bank branches operating in European Union member states or in third countries which do not run a deposit guarantee scheme or whose scheme is not equivalent to that of Greece (see p. 12).

The law does not empower TEK to take preventive action in order to support credit institutions in difficulty or save them from bankruptcy, a policy adopted by some other EU countries, including Denmark, Luxembourg and the United Kingdom. By contrast, the deposit guarantee authorities of Belgium, Germany, France, Spain, Ireland and Portugal can take preventive action by, for example, providing financial assistance to banks whose solvency is at risk.

TEK has fast consolidated its full operating potential. However, its existence and role are not yet generally known to the public. To ensure the successful fulfilment of its mandate, it is therefore important that savers are provided with accurate information regarding TEK's role and status.

Management

Law 2324/95 entrusts the administration and management of TEK to a Board. The Board is composed of seven members, appointed by the Ministry of National Economy, and is chaired by one of the Deputy Governors of the Bank of Greece. The other six members are selected from the Bank of Greece, the Hellenic Banks' Association and the Ministry of National Economy. (It may be noted that the governing bodies of other European deposit-guarantee schemes are similarly composed.) Very substantial expertise is thus brought to bear on the decision-making of the body. The term of office of board members is five years and can be renewed only once.

The Board is the supreme decision-making body of TEK and can decide on all matters related to the fulfilment of TEK's mandate. Its task is to manage and direct the affairs of the Fund, as well as to represent the Fund in any official capacity. The chairman represents TEK before all government authorities, third parties and courts of law, and may, on occasion, be substituted by

another Board member. Further, the Chairman may, under certain conditions, delegate the representation of TEK before all government authorities or third parties to the Director of TEK.

Participation of credit institutions

Law 2324/95 requires that all credit institutions authorised to conduct business in Greece (with the exception of the Postal Savings Bank and the Deposit and Loans Fund) participate in TEK. The central feature of participation is the regular payment by credit institutions of annual contributions, which are pooled and managed by TEK so as to secure the funds required for the fulfilment of its mandate. Participation is also required of branches in Greece of credit institutions whose head offices are located in non-EU countries, if their home country does not have an equivalent deposit guarantee scheme. Branches in Greece of credit institutions from other EU countries may also participate on a voluntary basis, for supplementary cover, if the deposit guarantee scheme of their home country is not equivalent to the Greek scheme in terms of level and/or scope. In this case, TEK, bilaterally with the scheme of the home member state, lays down appropriate rules and procedures for the payment of supplementary compensation to the depositors of the branch concerned.

The mandatory nature of participation in TEK implies that penalties are imposed

on credit institutions which default on their obligations to TEK. The Bank of Greece, in conjunction with TEK, is empowered to impose such penalties, as prescribed in Law 2076/92, which sets out the supervisory tasks of the Bank of Greece. If, twelve months after the imposition of such penalties, the credit institution has still failed to fulfil its obligations, TEK may exclude it altogether from the scheme.

The Greek banking industry has recently seen considerable restructuring and consolidation. As a result, TEK currently has a membership of twenty-nine credit institutions, of which twenty are Greek banks and nine are branches of banks from non-EU countries (see Table 1).

The recent restructuring in the Greek banking sector has not, however, had a major impact on TEK's finances. Although the breakdown of deposits and contributions may change as a result of mergers and acquisitions, the total amount of contributions will not be affected. Arguments have been put forward for setting slightly lower levels of compensation liability, such as a) a depositor having accounts in more than one bank involved in a merger may be entitled to compensation for his/her aggregate deposits up to the stipulated level of cover; and b) the larger the credit institution (the consolidation pattern in the Greek banking market is increasingly pointing in this direction) the less likely it is that deposits will become unavailable.

Table 1
Credit institutions participating in TEK

A.	Greek banks
1.	Agricultural Bank of Greece
2.	Alpha Bank
3.	Aspis Bank
4.	Bank of Attica
5.	Citibank Shipping Bank
6.	Commercial Bank of Greece
7.	EFG Eurobank
8.	Egnatia Bank
9.	Ergobank
10.	General Bank of Greece
11.	Investment Bank of Greece
12.	Laiki Bank (Hellas) S.A.
13.	Macedonia-Thrace Bank
14.	National Bank of Greece
15.	National Bank of Industrial Development (ETBA)
16.	National Industrial Development Investment Bank (ETEBA)
17.	Piraeus Bank
18.	Piraeus Prime Bank
19.	Telesis Investment Bank S.A.
20.	Xios Bank
B.	Branches of credit institutions from non-EU countries
21.	American Express Bank Ltd
22.	ANZ Grindlays Bank Ltd
23.	Arab Bank P.L.C.
24.	Bank of America N.A.
25.	Bank Saderat Iran
26.	Citibank N.A.
27.	Cyprus Bank Ltd
28.	Hellenic Bank Ltd
29.	The Bank of Nova Scotia

Sources of financing and revenue

TEK is financed through a mixed system (see Annex I), which combines regular and extraordinary sources. Regular sources comprise the initial capital, entry fees and members' regular annual contributions; extraordinary sources comprise additional

contributions, donations, liquidated claims, and borrowing.

a) *Regular sources*

i. TEK's initial capital was set at GRD 3 billion, of which 60 per cent was paid up by the Bank of Greece and 40 per cent by the initial member credit institutions of TEK. The share to be paid by each institution was determined by the Hellenic Banks' Association. This capital is the property of TEK; it does not change with the entry of new members and no refund is envisaged by Law 2324/95.

ii. Credit institutions that join TEK subsequent to the initial start-up of the Fund have to pay an entry fee which is calculated in accordance with specifications set out by law.

iii. All credit institutions covered by TEK are required to pay regular annual contributions. These are calculated on the basis of the average outstanding balance of their total deposits in drachmas and foreign currency each June, according to a degressive scale, which for 1999 was the following:

Average balance of total deposits (in billion drachmas)	Percentage contribution rate
0 - 142	0.1250
142 - 600	0.1200
600 - 1,175	0.1175
1,175 - 6,000	0.0205
over 6,000	0.0025

The deposit brackets are adjusted on an annual basis, subsequent to decision by the Board, so that the ratio of total annual contributions to total guaranteed deposits remains at the same level as in TEK's first year of operations.

Regular annual contributions are paid by credit institutions in two equal instalments, one on the first working day of September of the current year and the other on the first working day of the following March.

Payment is effected as follows:

a) 80 per cent of the amount payable is deposited by credit institutions into 3-month time deposit accounts held by TEK with them. At maturity, deposits are renewed and accrued interest is capitalised. New or renewed deposits are remunerated at a rate equal to the 3-month Treasury bill rate applicable on the date of the new deposit or renewal. According to Law 2324/95, when the Deposit Guarantee Scheme is activated, TEK's accumulated deposits with credit institutions are promptly made available to TEK, notwithstanding any other legal provisions, and before any other claim is satisfied.

b) The remaining 20 per cent is credited to TEK's current account with the Bank of Greece and, once TEK's operating expenses have been covered, the amount is invested in short-term government paper (issued with a maturity of up to twelve months).

According to the law, when the Board considers that TEK's accumulated resources have reached a reasonable level relative to covered deposits, it may decide to calculate the regular contributions not on the basis of total deposits, but on the basis of total annual increments on deposits.

b) Extraordinary sources

i. If TEK's accumulated resources deriving from regular sources are not sufficient to compensate the depositors of a credit institution in liquidation, member credit institutions are required to pay additional contributions. The amount of such contributions is specified by decision of the Board. It can be up to three times as high as the regular annual contribution, and is offset against subsequent regular annual contributions as determined by decision of the Board.

ii. The law also provides for other sources of extraordinary revenue: donations to TEK, the collection of TEK's claims against credit institutions arising from the payment of compensation to depositors, and loans that TEK may raise from participating credit institutions, as stipulated by law, if the regular and extraordinary sources of financing are not sufficient to cover the compensation to be paid.

Level and management of accumulated resources

Figures for TEK's accumulated resources as at 31 December 1999 are set forth in Table 2, while Table 3 presents the sources of financing to be used in the event that the Deposit Guarantee Scheme is activated. As can be seen in Table 2, by end-1999, TEK had accumulated resources of GRD 81,166

Table 2

Total accumulated resources

(in GRD)

Resources \ Year	1995	1996	Per-centage change 1996/1995	1997	Per-centage change 1997/1996	1998	Per-centage change 1998/1997	1999	Per-centage change 1999/1998	Resour-ces ¹ accu-mulated at 31.12.99
Initial capital	3,000,000,000									3,000,000,000
Contri-butions	9,805,861,435	11,423,303,431	16.49%	12,988,644,153	13.70%	14,643,343,340 ²	12.74%	15,506,181,838	5.89%	64,367,334,197
Interest ³		1,720,958,890		2,327,810,717	35.26%	4,402,970,588	89.15%	5,347,220,913	21.45%	13,798,961,108
Total	12,805,861,435	13,144,262,321	2.64%	15,316,454,870	16.53%	19,046,313,928	24.35%	20,853,402,751	9.49%	81,166,295,305

1 Including operating expenses, depreciation and compensation paid to the depositors of the Arab-Hellenic Bank.

2 Including initial contribution of GRD 50,898,166.

3 After tax.

Source: TEK.

Diagram 1

Annual increase in accumulated resources
(in GRD millions)

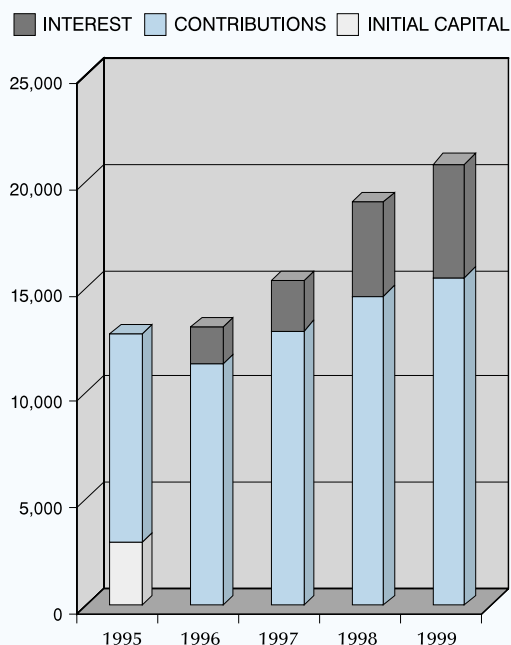
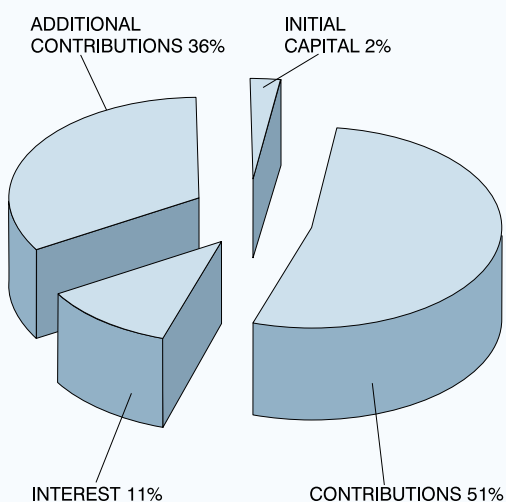


Diagram 2

Sources of financing in the event of activation
of the deposit guarantee scheme at 1/1/2000



Source: TEK.

Table 3

Sources of financing in the event
of activation of the Hellenic Deposit
Guarantee Scheme at 1/1/2000 (in GRD)

A. Total accumulated resources¹	81,166,295,305
Initial capital	3,000,000,000
Contributions	64,367,334,197
Interest ²	13,798,961,108
B. Potential resources³	46,518,545,514
Additional contributions	46,518,545,514
Total (A+B)	127,684,840,819

1 Including operating expenses, depreciation and compensation paid to the depositors of the Arab-Hellenic Bank.

2 After tax.

3 Loans, donations, revenue from liquidation of TEK's claims and the management of assets are not included.

Source: TEK.

million. This figure includes the initial capital, total contributions paid, and interest income. Net of operating expenses, depreciation and compensation paid to the depositors of the Arab-Hellenic Bank, TEK's total accumulated resources came to GRD 80,664 million at end-1999. The available data suggest that the annual rate of increase in TEK's resources exhibits a strong upward trend, aided by changes in the contribution base and in the level of interest rates.

In 1999, TEK's resources invested in Greek Treasury bills or held in time deposits yielded an average of 8.8 per cent.

TEK's scope for higher-yield investment is appreciably constrained by the existing legislation, which states that the resources of TEK can only be invested in short-term securities, so as to facilitate liquidation in the event that the scheme is activated.

How the Deposit Guarantee Scheme is activated

A credit institution's inability to repay its deposits is determined, in principal, by the Bank of Greece. When such a situation arises, the Bank of Greece issues a formal decision. The credit institution's inability to repay deposits can also be determined by a court ruling, which may be issued in advance of any action by the Bank of Greece or, in the case of a branch of a credit institution based in another EU member state participating in TEK for supplementary cover, by decision of the supervisory authority of the home country of the credit institution concerned.

As soon as the decision of the Bank of Greece or of the home country supervisory authority or the ruling of the judicial authority has come to its knowledge, TEK moves to:

- draw up a list of the depositors who are entitled to compensation, on the basis of data provided by the credit institution in question;
- set off the depositors' claims against any counterclaims of the credit institution;
- inform depositors through the daily press or by mail of their right to compensation; and
- pay compensation in respect of unavailable deposits within three months of the date when the deposits became unavailable. This time limit can be

extended by no more than two further 3-month periods.

According to the law, TEK is subrogated to the rights of the depositors whom it has compensated. The depositors' right to compensation lapses five years after the end of the last extension of the time limit set for the commencement of the compensation procedure.

At its outset, TEK undertook to pay compensation totalling GRD 650 million (cf. Article 55, Law 2324/95) to the depositors of the Arab-Hellenic Bank, which had already been placed in liquidation. This amount was paid by the Bank of Greece before TEK had been set up, and was subsequently offset against the Bank's obligation to participate in the initial capital of TEK. The total amount to be paid out to the depositors of the Arab-Hellenic Bank is estimated at GRD 583.5 million. For this amount, TEK will be subrogated to the depositors' rights, and consequently will thereafter have an equivalent claim on the proceeds from the liquidation of the assets of the Arab-Hellenic Bank.

Arab-Hellenic Bank's assets have already been sold by auction, yielding GRD 524.4 million for TEK, and thus satisfying TEK's claim in full.

Depositors entitled to compensation and level of cover

According to the law, any depositor whose deposit does not belong to one of the

excluded categories (see below, p. 19) is entitled to compensation through TEK.

The maximum level of cover per depositor cannot exceed the drachma equivalent of EUR 20,000*, the conversion rate being the official rate (fixing) of the date when the deposits became unavailable, and applies to the aggregate deposits held by a depositor with the credit institution concerned, irrespective of the number of deposits, the currency of denomination or the location of the branch or branches, after set-off has been made against any counterclaims of the credit institution. The law stipulates that this limit may be adjusted by decision of TEK's Board so as to comply with the minimum limit laid down by the relevant EU regulations. In the case of joint accounts opened in the names of two or more persons, each depositor's share is deemed a separate deposit and is covered up to EUR 20,000.

Greece, as is the case in a number of other EU Member States, has adopted the minimum guarantee level per depositor prescribed in Directive 94/19/EC. However, the cover offered by the deposit guarantee schemes of some Member States, such as Denmark, Germany, France and Italy, is much higher.

Where supplementary cover is provided to a local branch of a credit institution from another EU Member State, TEK, bilat-

* With the introduction of the euro, the term "ECU" employed in Law 2324/95 was replaced by "euro".

erally with the home member state of that branch, establishes the rules and procedures governing the terms and conditions of participation in TEK, and obtains from the home supervisory body any necessary information. TEK is entitled to charge EU bank branches for supplementary cover and will meet claims for supplementary compensation upon a declaration from the home Member State's supervisory body that the deposits held with the credit institution in question have become unavailable. The law, in an effort to ensure a level playing field for all EU credit institutions, also provides for cooperation between TEK and the deposit guarantee schemes of other Member States, in particular so as to agree on how the existence of a counterclaim which may give rise to set-off under either scheme will affect the compensation paid to the depositor by each scheme. However, to date this option has not been used.

Covered and excluded deposits

a) Covered deposits

As already mentioned, TEK typically covers aggregate bank deposits up to the equivalent of EUR 20,000 per depositor. The available data suggest that:

- i) the growth rate of the number of depositors is lower than that of deposits; and
- ii) the aggregate accumulated resources of TEK are increasing at a fast pace.

Given that the growth rate of guaranteed deposits seems to be lower than that of resources, TEK's self-sufficiency is increasing over time.

b) Excluded deposits

The following types of deposits are excluded from cover by TEK:

1) Deposits held by other credit institutions in their own name and for their own account;

2) all instruments falling within the category of credit institutions' "own funds" as defined in Bank of Greece Governor's Act No. 2053/1992 (Government Gazette A/49), as amended;

3) deposits arising from transactions in connection with which there has been a criminal conviction for money laundering or other illegal activity, as defined in Law 2331/95 (Government Gazette A/130) and any amendments thereto or in the relevant legislation of other EU member states;

4) deposits by financial institutions, as defined in Article 2 (6) of Law 2076/92 (Government Gazette A/130), insurance companies, and undertakings for collective investment in transferable securities (Ucits);

5) deposits by central government (ministries and decentralised government agencies);

6) deposits by a credit institution's own managers, as defined in paragraph 1(c) of Article 6 of Law 2076/92 (Government Gazette A/130), members of the board of directors, direct or indirect holders of at least 5 per cent of the credit institution's capital, persons responsible for auditing the credit institution's accounting documents and persons of similar status in other companies having direct or indirect control over the credit institution;

7) deposits by close relatives (spouses and children) or third parties acting on behalf of the depositors referred to in (6) above;

8) deposits by companies in the same group, as defined in Article 42e of Codified Law 2190/1920, as amended;

9) negotiable certificates of deposit (CDs);

10) bonds issued by credit institutions and liabilities arising from own acceptances or promissory notes;

11) liabilities arising from repurchase agreements (repos).

Obligations of credit institutions participating in TEK

All credit institutions and foreign bank branches operating in Greece are required to publish a detailed brochure in Greek for the information of their depositors. This brochure must contain the following data:

- the maximum level of cover per depositor and, in the case of branches of foreign banks, any responsibility of the depositor under the law of the home country;
- the currencies covered;
- the types of deposit which are excluded from cover;
- the requirement to set off any counter-claims of the credit institutions;
- the procedure, time limits and conditions for the payment of compensation.

This brochure therefore provides the public with essentially the same information across the various credit institutions, so as to avoid confusion that could give rise to unfair competition among credit institutions. The members of TEK, in complying with this requirement, have obtained TEK's approval for the content of their respective brochures and have already made them available to the public.

The law requires that credit institutions report to TEK data on their deposits, which serve as the calculation base for their contributions. These data include the following:

- balance sheets and profit and loss accounts;
- deposits and number of depositors;
- entries and outstanding balances of TEK's accounts with credit institutions.

TEK is not entitled to carry out audits on credit institutions. This competence lies with the Banking Supervision Department of the Bank of Greece as part of its authority to exercise general prudential control. The Banking Supervision Department communicates to TEK the findings of its audits regarding the proper calculation of credit institutions' contributions.

Supervision of TEK

TEK is supervised by the Ministry of National Economy. TEK is required by law to draw up an annual budget and an annual report, submit them to the Minister of National Economy for approval, and communicate them to competent authorities, committees and bodies, such as the Committee of Financial Affairs of the Greek Parliament, the Bank of Greece, the Ministry of Finance, and the Hellenic Banks' Association.

Organisational structure of TEK

TEK's organisational structure was established by decision of the Minister of National Economy. According to this decision, TEK comprises an Administration and Secretariat Unit, an Accounting, Asset Management and Compensation Unit, a Legal Unit, a Research and Relations with Credit Institutions and Deposit Guarantee Schemes Unit, and an Internal Audit Unit. With the exception of the internal auditor

who reports directly to the Chairman, the Units report to the Director of TEK, who is appointed by decision of the Board.

TEK's operations are governed by its rules of procedure, which were drawn up and adopted by formal decision of the Board.

The Units are staffed with specialised personnel, currently totalling ten persons. The hiring, status and promotion of the personnel, who hold private employment contracts, are laid down in the relevant regulation adopted by the Board.

Cooperation with deposit guarantee schemes of other countries

To achieve its objectives, TEK relies on close cooperation and exchange of information with other deposit guarantee schemes, mostly in Europe, though also in non-European countries. In formulating its development strategy, TEK draws heavily on the experience acquired by several European deposit guarantee schemes. Moreover, cooperation with other such schemes is essential in order to address effectively any problems that may arise as a result of differences existing between the various national schemes in the event that the domestic scheme is activated and is called upon to cover the depositors of a member's branch located in another EU Member State. Considerable efforts are also being concentrated on the study of the deposit guarantee schemes of the Balkan countries, in view of the growing presence

of major Greek commercial banks in the banking markets of this region.

Cooperative banks

Law 2324/95 contemplates the participation in TEK of credit institutions that operate in the form of credit cooperatives. However, such participation has not as yet occurred. The matter is currently under consideration and it is anticipated that cooperative banks will soon be admitted to TEK.

The participation of cooperative banks in TEK should help them to play more effectively their special role in the financial system. Greece currently has several cooperative banks and credit cooperatives, which were established with the ultimate purpose of conducting principally banking operations, following authorisation by the Bank of Greece, as prescribed by legislation.

Current status and future outlook

The increasing risk of financial shocks spilling over across national borders of an EU Member State or third country made the adoption of minimum common supervision rules throughout the European Union imperative. The European single banking market project rests on the harmonisation of a minimum set of supervisory principles and concepts. To this end, Directive 94/19/EC has significantly advanced the harmonisation of deposit guarantee

schemes, while at the same time leaving organisational matters and other related areas (e.g. the maximum level of cover or resources) to the discretion of the individual national authorities.

The completion of EMU and the adoption of the single currency necessitate instituting equal conditions of competition across national borders. The same logic implies that member states should adopt a common approach to the issue of harmonisation, not only in terms of the minimum level of cover but also in terms of the maximum level. In this respect, it is likely that the role of deposit guarantee schemes in ensuring financial market stability will be enhanced.

In the European Union, however, the diversity of deposit guarantee schemes is not thought to pose a serious problem: differences used to exist even before the adoption of Directive 94/19/EC, without hindering the development of the single European market for banking products and services.

However one cares to see it, both European financial integration, involving market deregulation and full liberalisation of capital movements, and similar trends witnessed in the global environment point to the need for further cooperation among national deposit guarantee schemes.

It is worth noting that alongside the deposit guarantee scheme an investor compensation scheme has become operative. By Law 2533/99 (Article 61 seq.), Greek legislation was adjusted to Directive 97/9/EC of the European Parliament and of the Council on investor compensation schemes. This legislation provides for the restructuring and operation of the "Athens Stock Exchange Members Guarantee Fund", a legal entity governed by private law whose task is to pay compensation to investors in the event of a definite and irreversible failure of an investment firm to fulfil its obligations. Thus, deposit protection and investment protection legislation together form a comprehensive safety net encompassing all the sectors of the financial system.

ANNEX I

A. The rationale behind the establishment of deposit guarantee schemes, and their types

a) The problem of systemic risk

The notion of systemic risk concerns the possibility of a generalised banking crisis characterised by a massive withdrawal of deposits under conditions of panic, as a result of loss of depositor confidence, affecting not only fragile but also healthy banking institutions. In the context of today's highly globalised market environment, systemic risk can take various forms. It can derive either from financial difficulties faced by a limited number of credit institutions in a given country or from spillover effects stemming from regional and/or international shocks.

Deposit guarantee schemes are designed to reduce the likelihood of a generalised withdrawal of deposits under conditions of panic by providing guarantees for the protection of savers. Thus, they drastically reduce systemic risk and offer the competent authorities more room for manoeuvre and flexibility in addressing risky situations in the domestic banking system while at the same time serving as a means to cushion against external shocks.

Guarantees are needed by savers, in particular small savers, given their limited access to information that would enable them to assess properly the solvency of the credit institution with which they have entrusted

their savings. This calls for the establishment of a minimum level of coverage by the deposit guarantee scheme so as to address the situation that arises when one or more credit institutions fail to return deposits.

b) The problem of moral hazard

Although deposit guarantee schemes are designed to deal with and minimise systemic risk, they can actually have negative effects too, thereby fostering instability in their respective banking systems. This is because the safety net offered by such schemes may provide incentives for banks to assume excessive risks. This could take the form of excessive lending to borrowers who are not creditworthy or, more generally, a tendency toward imprudent management of their depositors' money. This is known as the "moral hazard" problem. Depositors, in turn, reassured by the existence of the guarantee schemes, may neglect to check the solvency of the credit institutions with which they place their deposits. This can lead to misallocation and misuse of resources and can have a dampening effect on the role of the market and market discipline in the banking system.

There are a number of ways in which deposit guarantee schemes can address the problem of moral hazard:

- i) Partially shared responsibility with a maximum cover level per depositor

In this case, small depositors are fully covered, while those who hold deposits

over a certain limit are covered only in part. The view underlying this approach is that large depositors are typically more aware of the financial situation of a credit institution and are able to negotiate better terms for their deposits.

ii) Fully shared responsibility

Every depositor, irrespective of the size of his/her deposit, has to suffer part of the loss of deposits (e.g. by sharing a small proportion of the loss, as deposits are covered up to a certain percentage). Such an arrangement provides a strong incentive for depositors to be more cautious and check the solvency of their banks.

iii) Risk-related contributions

The moral hazard problem can also be mitigated if credit institutions' contributions to the scheme are calculated on the basis of the risks they assume. A uniform method of calculation would imply a relatively heavier burden for risk-averse banks and would encourage the other banks to take high risks, taking advantage of this indirectly subsidised cover. Instead, under a risk-related contribution arrangement, a credit institution that chooses to engage in high-risk activities must bear the additional financial cost.

The Greek deposit guarantee scheme is a hybrid of the first two described above: it fully covers deposits up to EUR 20,000, while depositors are liable for themselves for any amount in excess of this level. No risk-related contribution has been adopted so far.

B. Ways of financing deposit guarantee schemes

Deposit guarantee schemes can be financed in the following ways:

- direct financing, i.e. regular contributions paid by participating credit institutions;
- on-call payments effected only in the event that the scheme is activated;
- mixed-type financing, whereby part of the resources consists of regular contributions and part of on-call payments upon activation of the scheme.

The first type of financing is used in the deposit guarantee schemes of Spain, Sweden and the United States, while those of France, Italy and Austria rely on the second type. The Greek system and those of Belgium, Denmark, Germany and the United Kingdom employ a mixed-type system.

It may be argued that, in the event of activation of the deposit guarantee scheme, a system that forms an adequate pool of funds out of regular annual contributions is better than a system of on-call payments since credit institutions are not called upon to incur an unexpected and high cost at the moment when the activation of the scheme becomes necessary.

The mixed type of financing is an attempt to combine the advantages of the other two types, as well as to ensure more cost-efficient operation, with members shouldering a reasonable cost.

ANNEX II

A. Directive 94/19/EC on deposit guarantee schemes

Besides adopting legislation on the harmonisation of banking supervision rules (Second Banking Directive, Directive on the own funds of credit institutions, provisions of the Treaty on European Union regarding the independence of central banks), the European Union, judging that the harmonious development of the activities of credit institutions throughout the Community has to be accompanied by the enhanced stability of the banking system, adopted Directive 94/19/EC of the European Parliament and of the Council on deposit guarantee schemes.

The directive requires that the depositors at all the banks of the European Union Member State – as well as at branches of foreign credit institutions, in view of the principle of single authorisation throughout the European Union and the principle of supervision by the home Member State – be covered by a deposit guarantee scheme. In addition, under the directive every credit institution is required to join a deposit guarantee scheme, otherwise it is not entitled to accept deposits or carry out other banking operations.

Directive 94/19/EC reflects an effort to bring the various deposit guarantee schemes currently operative in the EU into line with one another. The harmonisation of deposit guarantee schemes is seen as an essential element in the completion of the single banking market, alongside the

harmonisation of banking supervision rules. The directive focuses on ensuring that compensation is paid promptly, as well as on setting a harmonised minimum level of guarantee, rather than dealing with organisational details. The minimum guaranteed level has been set at EUR 20,000 and compensation has to be paid within a time limit of three months, which, in exceptional circumstances, can be extended twice, each time for up to three months. These time limits aim to uncouple the procedure for the payment of compensation from the liquidation of a credit institution, and thereby maintain depositor confidence in the banking system.

As already mentioned, the directive represents a compromise between varying national deposit guarantee schemes. This is evident from the fact that member states are given the option to introduce the principle of shared responsibility into their respective schemes. This option was considered useful for the coexistence of schemes that provide full protection, whether directly or indirectly, and schemes primarily guided by the need to deal with moral hazard.

To avoid any distorting effect on competition from the ability of individual deposit guarantee schemes in the European Union to offer higher cover than the minimum level of EUR 20,000, the directive has incorporated two guiding principles:

a) the “top-up scheme” principle, according to which the host Member State scheme

may offer supplementary cover to branches of foreign banks authorised in its territory, so that these can offer the same level of deposit guarantee as that offered by the scheme of the host Member State;

b) an “export-ban clause”, according to which the level of cover offered by the home Member State scheme to foreign branches of domestic credit institutions must not exceed the maximum level of cover offered by the deposit guarantee scheme of the host Member State.

These principles, which aim at creating a level playing field within the territory of Member States, remained in effect until 31 December 1999. Prior to this date, the European Commission reported to the European Council its assessment of member states’ compliance with the requirements of the directive and did not propose any extension of the validity of the principles.

Lastly, the directive allows deposit guarantee schemes to cover all deposits irrespective of their currency of denomination. At present, the schemes of ten EU Member States guarantee deposits denominated in all currencies, while the remaining cover deposits in EU currencies only and exclude third currencies (e.g. US dollars).

B. Deposit guarantee schemes in selected countries

The United States was the first country to introduce a deposit guarantee scheme. This

happened in the early 1930s, during the Great Depression when public confidence in the banking system was seriously damaged and a large number of banks went bankrupt. The Federal Deposit Insurance Corporation (FDIC) that was set up continued operating until 1990, providing two types of deposit protection: first, it guaranteed all deposits up to a limit of USD 100,000; and second, it provided *de facto* protection to depositors by taking over the liabilities of banks undergoing difficulties and saving them from bankruptcy. These guarantees were later revised and adjusted to changing market conditions so as to avoid side effects from banks assuming excessive risks – in particular, the moral hazard problem. Specifically, under more recent decisions, the FDIC has used the “least-cost rule”, according to which ailing credit institutions are salvaged only if the cost of restoring their soundness is lower than the claims of depositors.

In Sweden in the early 1990s, and before EU regulations, the difficulties faced by several banks seriously disturbed the normal operation of the financial system. The effort to restore normal operating conditions for the banking sector in a quite volatile and unstable economic environment increased the role of deposit protection in ensuring financial stability. With a view to enhancing market discipline and increasing depositors’ incentives to examine the solvency of the banks with which they entrusted their savings, the authorities set the maximum

limit of cover at SEK 250,000 (EUR 28,000), while the contributions paid by members were closely related to the risks assumed by them.

In Germany, the deposit guarantee scheme offers virtually unlimited protection, as the official maximum level of cover per depositor is 30 per cent of the bank's own funds. The competent authorities do not pay particular attention to the role of market discipline, whether through shared responsibility or through a maximum level of cover. Annual contributions are based on a flat rate (0.03 per cent of liabilities to

private depositors), while supplementary contributions are not precluded.

The scheme of the United Kingdom guarantees 90 per cent of deposits per depositor up to a maximum of EUR 20,000, thus combining shared responsibility and a maximum level of cover. This combination is considered a further means to maintain stability in the banking system.

The cases outlined above indicate that the operating rules of deposit guarantee schemes can vary widely from one state to another.

Table 4: Ways of financing deposit guarantee schemes

Country	Regular contributions	Extraordinary contributions (on call)	State financing
Austria	—	Calculated on the basis of each bank's share in total guaranteed deposits. Maximum level of contributions: 1/3 of banks' reserves	If pooled funds are not sufficient, the scheme may issue Treasury-guaranteed bonds
Belgium	0.02% of guaranteed deposits	Up to 0.06% of guaranteed deposits, if pooled funds are not sufficient for compensation payments	The State provides insolvent state-owned credit institutions with a guarantee for BEF 3 billion (EUR 74,368,057)
Denmark	Up to 0.2 per cent of total deposits, allocated on the basis of each bank's share in total guaranteed deposits	—	—
Finland	0.05-1% of total bank assets, allocated on the basis of each bank's solvency ratio and share in total guaranteed deposits	Regular annual contributions can be increased, if necessary	If pooled funds are not sufficient, the scheme may borrow under government guarantee
France	—	Flat contribution of up to FRF 200,000 (EUR 30,490), irrespective of size of credit institution, plus a percentage of the sum total of each bank's deposits and 1/3 of its lending—	—
Germany	0.03% of banks' liabilities vis-à-vis private depositors	Up to 0.03% of banks' liabilities vis-à-vis private depositors, if necessary	The central bank finances the Liquidity Consortium Bank, which provides financial assistance to credit institutions facing liquidity problems—
Greece	According to a scale	Up to three times as high as the annual contribution, if necessary	—

Ireland	—	One-off contribution of 0.2% of total deposits. No regular annual contribution. Extraordinary contributions, if necessary	—
Italy	—	A global amount of ITL 4 trillion (EUR 2.065 billion) is allocated among credit institutions, pro rata to the formula: deposits plus lending minus own	—
Luxembourg	—	Calculated on the basis of each bank's share in total guaranteed deposits. Annual maximum: 5% of each bank's own funds	—
Netherlands	—	Calculated on the basis of each bank's share in guaranteed deposits. Annual maximum levels: a) 10% of each bank's own funds and b) 5% of all banks' own funds	—
Portugal	0.8-1.2% of total guaranteed deposits, depending on each credit institution's solvency ratio	—	—
Spain	0.1% of total guaranteed deposits	—	—
Sweden	0.5% of total guaranteed deposits, depending on each credit institution's solvency ratio	—	—
United Kingdom	—	a) Entry fee by new members b) supplementary contribution to restore the level of pooled funds at GBP 3-6 million (EUR 4.25-8.50 million) and c) extraordinary contribution on call. Total contributions (regular and extraordinary) may not exceed 0.3 per cent of total guaranteed deposits	—

Sources: National deposit guarantee schemes and European Commission.

Table 5: Comparative data on EU deposit-guarantee schemes: legal status, participation, cover and power of preventive action

Country	Legal status	Participation of banks of non-EU countries	Maximum level of cover per depositor	Cover for deposits denominated in non-EU currencies	Cover for domestic banks' branches in third countries	Power of preventive action
Austria	Private	Compulsory*	EUR 20,000 (ATS 2.75,000)	No	Yes	Yes
Belgium	Private	Compulsory*	EUR 20,000	No	Yes (unless the host country has an equivalent scheme)	Yes
Denmark	Public	Compulsory*	EUR 40,255 (DKK 300,000)	Yes	Yes	Yes
Finland	Private	Compulsory*	EUR 25,228 (FIM 150,000)	Yes	No	Yes
France	Private	Compulsory*	EUR 60,979 (FRF 400,000)	No	Yes (only for EEA countries)	No
Germany	<u>TWO SYSTEMS</u> Public Private	Compulsory* Voluntary	EUR 20,000 30% of the liable capital of the Bank concerned per depositor	No Yes	Yes Yes	Yes Yes
Greece	Public	Compulsory*	EUR 20,000	Yes	Yes (unless the host country has an equivalent scheme)	No
Ireland	Public	Compulsory*	90 per cent of total deposits, up to EUR 20,000	No	No	Yes
Italy	Private	Compulsory*	EUR 103,291 (ITL 200 million)	Yes	Yes (unless the host country has an equivalent scheme)	Yes
Luxembourg	Private	Compulsory*	EUR 20,000	Yes	No	No
Netherlands	Public	Compulsory*	EUR 20,000	Yes	No	No
Portugal	Public	Compulsory*	EUR 25,000	Yes	No	No
Spain	Public	Compulsory*	EUR 20,000	Yes	Yes (only for EEA countries)	Yes
Sweden	Public	Compulsory*	EUR 28,000 (SEK 250,000)	Yes	Yes (voluntary)	No
United Kingdom	Public	Compulsory*	90 per cent of total deposits and up to GBP 18,000 (EUR 28,355)	No	No	No

* Unless the home country has an equivalent scheme.

Sources: National deposit guarantee schemes and European Commission.

Biographical notes on Board members

Nicholas C. GARGANAS – Chairman

Deputy Governor of the Bank of Greece. Formerly Director Advisor and Economic Advisor at the Bank of Greece.

He studied Economics at the Athens University School of Economics and Business (ASOEE), the London School of Economics and Political Science (M.Sc. Econ.), of which he is currently an Honorary Fellow, and University College London (Ph.D).

Panayotis S. RADAIOS – Vice-Chairman

Director Advisor of the Hellenic Banks' Association and Vice-Chairman of the Board of Directors of the Hellenic Development Company (ELANET).

Former Director at the National Bank of Greece, Managing Director of National Management and Organisation S.A. and Managing Director of Interbank Information Systems S.A.

He is a graduate of the Law School of the University of Athens.

Phoebus Chr. CHRISTODOULOU – Member

Professor at the Law School of the University of Athens and Head of the Legal Department of the Bank of Greece.

Sotirios A. REVITHIS – Member

Head of the Directorate of Macroeconomic Analysis of the Ministry of National Economy and member of the Board of Directors of Olympic Airways. He has served on the Directorates of National Accounts, European Affairs and Private Investment of the Ministry of National Economy, as well as on the Permanent Greek Delegation at the OECD.

He is a graduate of the Athens University School of Economics and Business (ASOEE) and the Department of Economics of the University of Athens, with post-graduate studies at the Institute of Social Studies, the Hague, Netherlands.

Antonios I. FOSKOLOS – Member

Director Advisor of the Hellenic Banks' Association. Former Director of the Montreal and Boston branches of the National Bank of Greece, Regional Director of the London branches of the National Bank of Greece and Director of Foreign Activities at the National Bank of Greece.

He is a graduate of the Law School of the University of Athens, with post graduate studies at the Business Administration Training Institute of the Athens University School of Economics and Business (ASOEE) and at McGill University, Montreal, Canada, and Boston University, Boston, USA.

Demetrios P. KATSIKIS - Member

He is Chairman of the Ioannis F. Kostopoulos Foundation. For a number of years he was Financial Director of Alpha Credit Bank and of the Alpha Group. He is member of the Board of Directors of the I. F. Kostopoulos Investment and Commercial Company S.A., member of the Board of Directors of Nautilus Shipping and Industrial Enterprises S.A., and member of the Greek Management Association.

He is a graduate of the Athens University School of Economics and Business (ASOEE) with post graduate studies in Business Administration.

Panayotis E. KYRIAKOPOULOS - Member

Director of the Monetary Policy and Banking Department of the Bank of

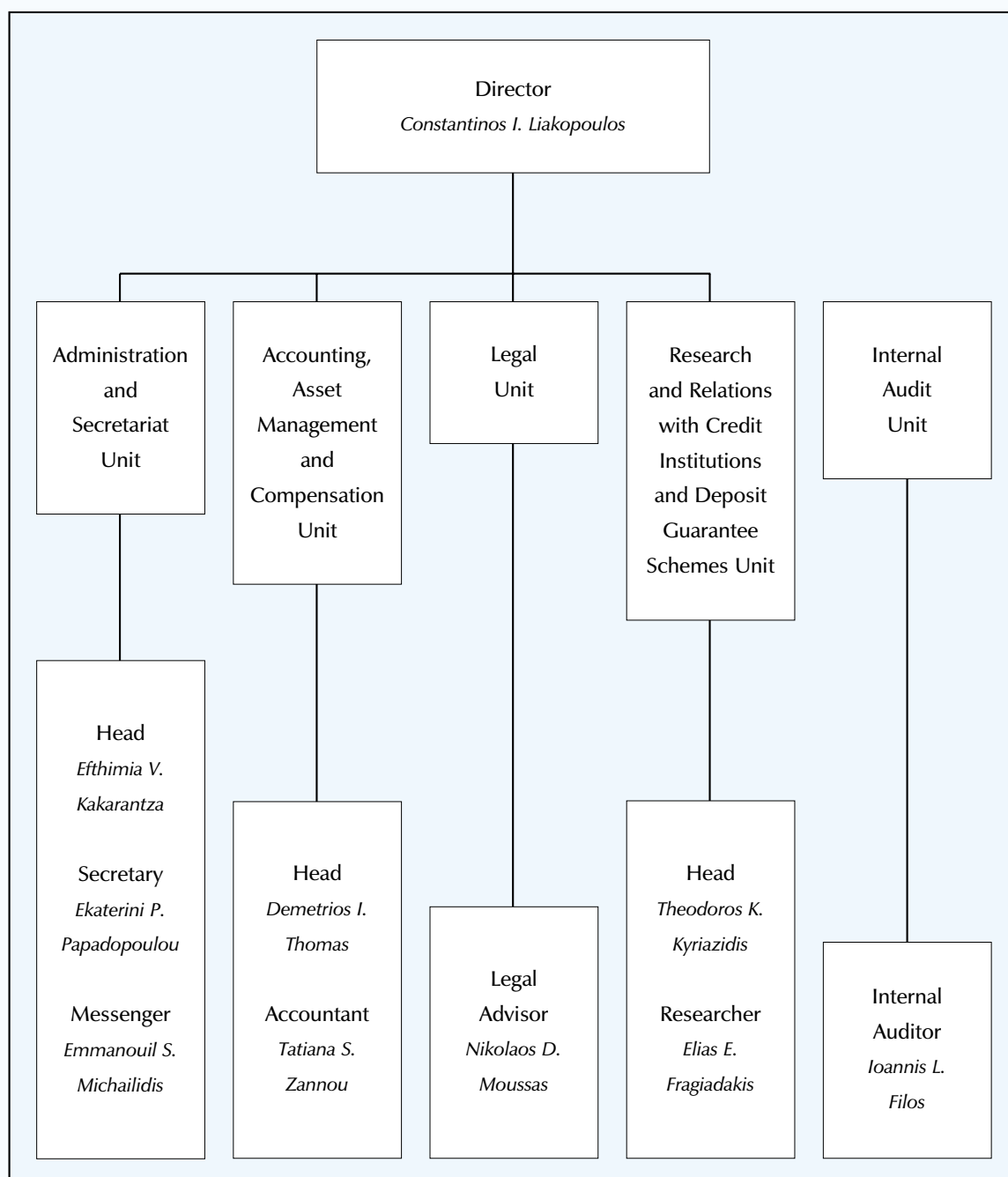
Greece. Member of the Banking Advisory Committee and of the Market Operation Committee of the European Central Bank. Former member of the Committee for the Modernisation of the Banking System and of the Board of Directors of the Capital Market Committee.

Iacovos P. VAHAVIOLOS

Director-Adviser of the Banking Supervision Department of the Bank of Greece. Member of the Banking Advisory Committee and of the Banking Supervisory Committee of the European Central Bank. Former senior officer at Citibank and member of the Capital Market Committee.

He is a graduate of Columbia College N.Y., with post-graduate studies at Harvard University, Boston.

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